Local Sources in Funding City and County Transportation Needs

PRELIMINARY DRAFT FOR DISCUSSION ONLY

This preliminary draft discussion paper is a work product developed by the consulting team for review and discussion by the Blue Ribbon Commission on Transportation. The contents are intended to provide the Commission members with factual background information and a balanced set of policy alternatives, including the pros and cons of these alternatives. This paper is one of a series and should be reviewed in the context of the entire series that, when taken together, presents a comprehensive overview of the state's transportation system.

This discussion paper series has been prepared primarily for Blue Ribbon Commission members new to these issues who wish to engage in a fundamental debate and for a more general audience of interested citizens who may wish to comment on the Commission's deliberations. This paper is intended to be provocative and to stimulate discussion of issues and options in funding transportation in this state. It questions the current ways of doing business, not for the sake of finding fault, but to allow consideration of other potential ways of thinking about basic funding issues that might be appropriate in the future.

INTRODUCTION

Local governments in Washington State receive an allocation of state gas tax to meet a portion of their roadway responsibilities. The remainder of their total transportation budgets are funded out of locally generated sources such as property taxes, sales taxes and local option transportation taxes as well as state and federal grants. Cities and counties report that available revenues are insufficient to both maintain and preserve the existing infrastructure and improve or add capacity to meet growth and changing demographics.

Local governments are additionally being squeezed in the demand for other services, whether public safety, open space or social services, as well as transportation. Cities and counties throughout the state also face widely different economic and political realities for approving new local revenues to meet these needs. If Initiative 695 were to pass in November and if it were to withstand a potential court challenge, any increases in taxes or fees would require voter approval.

This paper addresses the use of **local** revenue sources in funding transportation by cities and counties. A companion paper to this one, *Distribution of Gas Tax to the State, Cities and Counties,* examines issues related to how the gas tax is allocated.

ISSUE STATEMENTS AND BACKGROUND

While the citizen driving a vehicle in Washington perceives the roadway system as an interconnected network, the state's roadways are actually divided into state, county and city facilities. The state is responsible for state highways. Counties are responsible for the county roads and cities for city streets (state highways running through cities with populations over 22,500 are the exception and are the responsibility of WSDOT). Each level of government has access to different revenue sources with widely different characteristics. Local governments receive their authority to generate revenues to meet their responsibilities from the state Constitution and the Legislature.

1. From the layperson's perspective, this raises the question, "Why are the three levels of government treated differently with respect to their access to dedicated transportation sources and their need to fund transportation out of their general funds?"

Local governments raise the majority of their transportation revenues through the use of their existing local revenue authority.

- About 68% of city transportation funding is derived from locally imposed revenue sources, with the remaining 32% derived from state gas tax allocations, and from state and federal grants.
- About 50% of county transportation funding is generated locally, with the remaining 50% derived from the state gas tax and other sources.

This difference is historically rooted in that counties have a dedicated property tax for road purposes, the road levy, which by law is deposited in a county road fund and the purpose of which is the construction, preservation and maintenance of county roads, bridges and other transportation facilities. County road funds are comparable in some ways to enterprise funds or utility funds that have their own dedicated revenues and are accounted for separately from other government functions. (Electricity, water or sewer utilities are the most common kinds of enterprise funds used by government.) Cities have no such dedicated local revenue source, but rather fund their streets out of general fund sources like sales taxes, property taxes and other general fees and require transportation to compete against public safety, parks and recreation and other general fund activities. The state, similar to counties, has a separate transportation budget funded out of transportation-related sources like the gas tax, excise tax and vehicle license fees.

2. A second question is, "How can cities and counties be granted adequate and stable revenue authority to meet their transportation responsibilities?"

Cities and counties cite inadequate local taxing authority to fund their transportation responsibilities. In economic downturns or when new unfunded mandates are imposed on local governments, general fund sources shrink, leading to difficult trade-offs by policy makers and to increased instability in transportation funding. Property taxes and sales taxes are statutorily capped, so once at their legal limit can generate no revenue increases except those based on the growth of the underlying tax base. Cities are the only one of the three levels of government that fund their transportation responsibilities largely out of local sources that must compete with all other general government functions. (Dedicated local sales tax and MVET options exist only for transit use, and are not available to cities and counties for other transportation purposes.)

Seeking to add to local governments' transportation revenue base, and to increase funding stability, the Legislature granted cities and counties new local option transportation revenue authority in 1990. However, the local options have proven difficult to implement and produce little significant income to cities and counties.

Local Revenue Authority

Counties. Counties have been granted a dedicated road levy in their jurisdictions. The county road levy rate is up to $2.25 per $1,000 of assessed value (AV) which can be levied only in the unincorporated areas of the county. The road levy is subject to the 106% property tax limitation, meaning that in any given year, a jurisdiction can levy only 6% more than the average of the three previous years. (Thus, if the values of existing properties increase more than 6%, as they have, for example, in Puget Sound counties, increased revenues cannot, in the short run, capture the full increase in property values. The value of new construction is not included in the limitation.)

Counties (and cities) are now also limited to raising property taxes annually by the implicit price deflator (IPD) unless two-thirds of the legislative body of the jurisdiction votes to raise rates up to the 106% limit, or somewhere between the IPD and the 106% cap. (This change was introduced in 1998--prior to that, the road levy was imposed at the discretion of the county legislative body.) The county road levy is the single largest provider of road money for counties, raising $230 million in 1997, or about one-third of county road funds.

Of the 39 Washington counties, four were at the maximum road levy of $2.25 in 1998 (Ferry, Pend Oreille, Pierce and Walla Walla). Another two (Benton and Grant) were near the maximum at about $2.23. If the full levy had been imposed in all counties in 1998, it would have generated about $318 million statewide. Many counties, even though they impose less than the authorized $2.25, are constrained by the 106% cap and are imposing the maximum allowed by law.

An obvious political constraint on the county road levy is that it is a property tax. In recent years, public opinion in Washington and elsewhere has resisted increases in property taxes (except for specific, voter-approved purposes). For the past few years, the Legislature has sought to reduce property taxes or slow property tax growth in response to citizen concerns.

Other major county general fund revenue sources are a regular property tax levied in the incorporated and unincorporated areas of the county ($1.80 per $1,000 AV) and up to a 1.0% local option sales tax in the unincorporated areas. Fifteen percent of the sales tax collected in cities is statutorily assigned to the county government.

Cities. Cities do not have a dedicated transportation tax like the county road levy. Instead, they must allocate monies for city street maintenance and improvement from their general funds. Cities generate about 68% of their transportation revenues from local revenue authority that exists for all city purposes. Cities' local revenue authority consists of a general property tax ($3.60 per $1,000 assessed value), a local option sales tax of up to 1.0%, a business and occupation tax (derived from the general licensing fee authority) and utility taxes (all referred to as the general fund). In 1998, the Legislature began restricting the growth of the local property tax. Most cities impose at or near the maximum sales tax allowable (the exception being in the Oregon and Idaho border areas). The B&O tax is statutorily limited and imposed by only a few cities in Washington; utility taxes are limited in most cases.

Local Revenue Summary. Local governments receive significant portions of their additional (non-local) transportation funding from state and federal grant programs, most of which require some local match and all of which must be used for specified, limited purposes. So, in addition to inadequate local revenue authority to fund their basic transportation responsibilities, cities and counties must set aside portions of their available existing funds to match grant funds for construction projects, leaving many local governments without adequate funds to maintain and operate city streets and county roads to adequate levels. Additionally, the concurrency requirements of the Growth Management Act have caused many local governments to program their transportation dollars to meet the needs of new development or changing demographics, again constraining the funds available to meet the basic needs of their existing infrastructure.

The Road Jurisdiction Commission (RJC) study, conducted between 1983 and 1988, found that local jurisdictions were at or near their maximum local revenue authority. In fact, the RJC concluded, "If counties were able to collect all statutorily authorized revenues, total county road revenues would increase only 5%. The cities could increase road revenues by only 7% if full authorities were exercised."[1]

Whether or not that is an accurate statement today, local elected officials feel that their jurisdictions are at or near their ***viable*** maximum revenue authority levels. Having tapped most of their local revenues, cities and counties feel an increasing pressure to allocate their general fund monies (many of which have also been cut) to competing needs such as public safety, human services, economic development or open space, further squeezing transportation.

Other Local Option Funding Authority

The 1990 local option transportation revenue authority granted to local governments by the legislature consisted of the following local options:

[1] Final Report, *Route 2000, Washington Road Jurisdiction Study: Phase II, Analysis of Roadway Needs and Funding,* November 1988, page 6.

Local options authorized for counties

- A local option countywide gas tax of 10% of the state gas tax rate (or, currently 2.3 cents), subject to a vote of the people; revenues to be shared between cities and the unincorporated area based on population, with unincorporated areas receiving a 1.5 weighting of their population.
- A vehicle license fee (VLF) of up to $15 per vehicle (excluding trucks) without a public vote, but subject to referendum. Revenues shared with cities per the 1.5 unincorporated to 1.0 incorporated formula.
- A commercial parking tax on parking lot operators in unincorporated areas, without a public vote, but subject to referendum.

Local option gas tax. If it were implemented, this option is projected to generate $21 million in King County, $8.6 million in Pierce County, $6.6 million in Snohomish County and $5.2 million in Spokane County in 1998. However, since its authorization in 1990, the local option gas tax has not been implemented anywhere in the state. It was placed on the ballot once in Spokane and failed to receive a majority of votes. The measure was placed on the Snohomish County ballot twice and failed both times, even when, in the second effort, specific projects were identified for funding as part of a regional infrastructure initiative.

Arguments against the Snohomish County gas tax local option in 1998 were public confusion over its authorization as a percentage rate (rather than a specified amount), and the fear among gas station owners that residents would cross the border into neighboring counties to buy their motor fuel. Issues have also been raised about the feasibility of collection of a local option gas tax since the existing state gas tax is tracked and paid at the refinery rather than at the pump. Legislative fixes to this administrative issue have been identified, although not yet adopted.

Vehicle license fee (VLF). The $15 vehicle license fee local option has been implemented in King, Snohomish, Pierce, and Douglas counties. In these counties, the VLF in 1998 generated $20.5 million, $6.9 million, $7 million and $300,000, respectively. A referendum petition to repeal the VLF was begun in King County but failed to receive the necessary signatures to be placed on the ballot. The fee was implemented in Cowlitz County, but repealed through referendum.

Commercial parking tax. The unincorporated area commercial parking tax has not been implemented by any county, and the Washington State Association of Counties (WSAC) says it is of limited use to counties as most commercial parking facilities are in cities.

Local options authorized for cities

- A street utility fee, on both residential and commercial property at a rate of up to $2 per household per month and $2 per employee per month without a public vote.
- The commercial parking tax (same as above for counties).
- Shares of both the VLF and local option gas taxes if implemented by the county.

Street utility charge. The residential street utility had been implemented by 17 cities when it was declared unconstitutional in November 1995 by the state Supreme Court. The annual revenue loss to those cities totaled $14 million, more than half of which was a loss by the City of Seattle. All cities repealed their residential and commercial street utility charges following the court ruling and none exist in the state today.

Commercial parking tax. The commercial parking tax has been implemented in the cities of Bainbridge Island and SeaTac, communities with a "captive" parking audience. No other cities have implemented the tax because cities with sufficient density to have a commercial parking supply experience strong opposition to the parking tax from the business community, among others, especially retailers, who fear loss of business to areas with free parking.

Border area gas tax. A third local option of a 1 cent increase on the gas tax for state and international border areas was authorized prior to 1990. Blaine, Sumas, Nooksack and Point Roberts in unincorporated Whatcom County have implemented this authority.

Other local option funding authority available to local jurisdictions includes the transportation impact fee on new development, authorized by the Growth Management Act, and mitigation fees authorized by SEPA. Some local governments in rapidly growing areas are able to make good use of such fees, although statewide figures are not available as there is no reporting requirement. Selected examples include King County which has averaged $4.58 million in transportation impact fees in the 1991-98 timeframe, and the City of Redmond which has averaged $2 million in recent years.

POTENTIAL SOLUTIONS

Many ideas to "fix" the existing local authority to raise transportation revenues as well as new local option ideas have been advanced over the past few years.

Fixing the Existing Disparity in Access to Dedicated Funds

If the roadway system is viewed as an interconnected network of state highways, county roads and city streets, then a comprehensive transportation funding policy would have a similar, system-based approach. Each of the three levels of government would have proportionate access to dedicated user fee-generated sources such as the gas tax, excise taxes and license fees as well as locally authorized general purpose sources to be allocated based on local needs and priorities. Ideally, such a broad new policy would be agreed upon by all three levels of government.

For example, cities could receive authority to impose a dedicated road revenue, much like the street utility charge that was authorized but found unconstitutional several years ago. Such authority would be parallel to and proportionate to the county road levy and the various dedicated taxes and fees available to state government. Concomitantly, the state gas tax would be allocated to the state, counties and cities according to a proportional scheme.

Such an approach, agreed upon by the three levels of government, might determine that basic operation and maintenance at all levels should be funded out of dedicated, stable and predictable revenues. Safety improvements might also be funded out of dedicated funds. Growth-related or economically necessitated improvements might be funded from dedicated sources up to a certain agreed-upon level, to be matched by general purpose funds based on local needs and priorities.

If the three levels of government agreed that general fund monies should be used to fund transportation (in competition with other government functions), then each level of government might be required to allocate an agreed upon level of its budget in this manner. Balancing the highly variable capacity of jurisdictions with rich or poor tax bases would have to be considered. Clearly, this discussion raises fundamental questions about general revenue authority and revenue responsibility in transportation. It also implies consideration of significant revisions to the way responsibility for generating transportation revenues is viewed at all levels as well as the role and responsibility of different governments' control over funding.

The Road Jurisdiction Study of the late 1980s proposed an approach based on a combination of the needs and funding capacity of each jurisdiction. Other approaches might include fund allocation based on combinations of such factors as population, roadway miles, roadway usage (e.g., vehicle miles traveled) or economic development needs. The Revenue Committee and the Blue Ribbon Commission as a whole are invited to consider these issues and engage in a debate about whether the structure of our transportation funding system is due for a reevaluation as the state moves forward.

Fixing the Existing Local Options

Following are suggestions that have been offered and considered for making the current local options more viable for local governments to implement.

- **Allow cities, or cities and counties together, to use the vehicle license fee (VLF) in a transportation benefit district**. (A transportation benefit district, or TBD, may be formed by cities, towns and counties to fund capital improvements of city streets, county roads and state highways. Funding mechanisms for a TBD include property tax levies, general obligation bonds and development fees related to transportation projects. The Point Roberts TBD in Whatcom County is the only current TBD in the state).

  VLF is currently reserved for county implementation and this proposal assumes that a county has not used its VLF authority. Statutory amendments adopted in 1998 authorize less than countywide use of the VLF and require a public hearing and include "reversionary" rights if a county wanted to use the countywide fee at a later time. The $15 VLF has been a useful tool for some counties, although the amount it would raise in most cities is modest. It is viewed as equitable, simple to administer and flexible by jurisdictions currently using it. The counties have opposed city use of the VLF in the past on the grounds that more counties may eventually use it for countywide benefit, not just the benefit of a single city.

- **Amend the local option gas tax to a flat rate**. This proposal would amend the local option gas tax from a percentage of the state rate (currently 10% of 23 cents) to a flat rate (e.g., 3 cents or some other flat amount). As proposed, this option is simpler than the current design, although still restricted to road purposes. The arguments in support of this idea are that it would be easier to explain to the public, that it could potentially raise more revenue than the current rate, and that it would offer increased predictability in the generation of revenue. The arguments against the local option gas tax are put forth by the petroleum industry and others who are concerned about "balkanization" and unfair competition among dealers in adjacent jurisdictions that have not levied the local option. There is an additional concern about the difficulty of collecting different taxes in different jurisdictions around the state.

- **Amend the local option gas tax to remove the requirement that it be subject to a vote of the people.** The primary obstacle to the local option gas tax is the requirement of voter approval. In the two counties in which it has been placed on the ballot, it has failed to receive the needed votes. The proponents of this option argue that it would generate needed revenues that would be used in the region where the funds would be spent (thus a productive and equitable source). Arguments against this "fix" are the same as above: unfair competition across county lines and difficulty in collection of the tax. To ease tax collection, a statutory fix would be needed now that fuel distributors no longer report fuel sales by county.

- **Amend the commercial parking tax to include parking provided by employers**. Extending the commercial parking tax to include parking provided by employers was opposed by numerous large employers when it was proposed in the 1998 legislature. However, it would allow jurisdictions that have large amounts of free employer-provided parking to capture revenue and create a disincentive to auto use. Levying the tax on parking provided to commuters rather than to people going shopping or running errands would offer the benefits of reducing some trips without creating the unintended consequence of harming retailers.

Other Local Option Ideas That Have Been Advanced

1. **Create a local option sales tax for transportation (e.g., 0.1%).** There is precedent in that local governments can levy a 0.1% sales tax for criminal justice and counties can levy a 0.1% sales tax, both with voter approval, to pay for jails.

2. **Allow cities to impose their ordinary business and occupation tax on the sale of gas.** As with the sales tax on gas, there is uncertainty about whether this B&) tax on gas would be subject to the 18th amendment and thus limited to highway purposes.

3. **Permit counties to impose a B&O tax or a utility tax in unincorporated areas and earmark it for transportation**. Cities already have authority to impose B&O taxes on all businesses and utility taxes on electricity, natural gas, water, sewer and telephone services, however counties do not.

4. **Allow cities to create a city street levy and impose up to 50 cents per $1,000 of AV**. This would allow a levy upon creation of a voter approved city street district, and earmarking of unused local property tax authority up to cities' existing maximum of $3.60 per $1,000.

5. **Allow cities to create a "wheel" tax or vehicle registration fee**. Similar to the VLF, but for cities (cities now receive a percentage of the county VLF where levied.)

6. **Expand the local option MVET.** Currently such an option exists but is limited to high capacity transit and for HOV lane development, and only in certain parts of the state. This would authorize all cities or counties to use it for any transportation purpose; it could be either a credit against the state MVET (like transit's MVET) or an additional charge.

7. **Create neighborhood or business improvement areas for street maintenance**. Allow cities (and residents) to create a taxing district analogous to a business improvement area (BIA) for purposes of roadway maintenance and repair**.**

8. **Grant counties general license fee authority to be earmarked for transportation**. The general business license fee authority granted to cities includes the B&O tax and the employee charge. These could be extended to counties for use in unincorporated areas.

9. **Establish local option "regional" taxes**. This might take the form of an increase in the gas tax in a two or three-county area (or in a district with other defined boundaries) with proceeds remaining in that area for transportation. Such proposals are sometimes also called congestion relief districts.

The table on the following page compares these other local option ideas, showing what each would do, an estimate of revenue productivity, and a brief assessment of the proposal.

Other Suggestions to Increase Local Governments' Transportation Revenues

A number of other suggestions have been made by cities and counties either to the Revenue Committee directly or through other studies in last 10-15 years. While the first two options are state taxing measures, not local options, they could potentially generate significant revenues for local government and have city and county support.

- **Gas tax indexing**. One suggestion is to index the gas tax to inflation to allow it to keep pace with purchasing costs for transportation services. This proposal would benefit all gas tax beneficiaries, including the state, not just local government. This recommendation has been made by many committees or groups reviewing transportation funding in the past 15 years. Both the cities and counties suggested this change in their presentations to the Revenue Committee. A variant of this idea that was proposed by the Governor and others in 1998 is to cap the annual adjustments to a 601-type formula that limits gas tax increases to population and inflation increases each year.

Indexing the gas tax to inflation requires a change in state law and some administrative challenges to state regulators as well as to the petroleum industry. A gas tax growth factor would increase both adequacy of revenues and create a more stable revenue base without the need for continual action to adjust revenues. It would also improve the parity between the gas tax and the numerous other taxes that are structured to keep pace with the state's economy (e.g., state and local sales taxes, B&O taxes, property taxes.)

Evaluation of New Local Option Proposals

	What It Would Do	Revenue Productivity	Comments/ Assessment	Stakeholder Perspectives
1. Local option sales tax (0.1%)	Earmarked for local transportation	Excellent	Equitable, simple, flexible	
2. City B&O tax on gas	Allow cities to impose B&O on gas up to 2% of gross receipts	Excellent	B&O tax already viewed as unfair in many locales; flexible	Not much support in legislature; opposed by petroleum industry, business
3. County B&O or utility tax	Allow counties to impose B&O or utility tax in unincorporated areas	Good/fair	Many jurisdictions do not impose these taxes	Opposed by business, utilities
4. City street levy (up to 50 cents per $1,000)	Allow cities to form street districts & impose what is left under their $5.90/$1,000	Excellent	Existing property tax authority; very few cities could/would use	Likely citizen opposition
5. Wheel tax or vehicle registration fee	$10-20 fee for privilege of using streets	Good/fair	Similar to VLF	Might have same problem as street utility fee
6. Local option MVET	Increase 2.2% rate or credit against state share, imposed locally	Excellent	I-695 already on ballot would eliminate most MVET	Likely opposition by citizens, auto interests if an increase
7.Neighborhood or business improvement areas	Allow cities to create taxing districts for street maintenance	Low	Similar to LID or BIA	
8. General license fee authority for counties	Counties would be able to impose a B&O tax or an employee charge	Good/fair		
9. Regional taxes (e.g. gas taxing district)	Special regional district for roadway purposes	Excellent	Equitable; addresses issues of fragmentation; may undercut statewide funding	Petroleum industry, some state officials oppose

- **State sales tax on gas (6.5%).** Currently the statewide sales tax is not imposed on motor fuel. If it were extended to gasoline, it would raise the price of gas by some 6 to 10 cents per gallon. Its benefits would be excellent productivity and flexibility as experts believe it would not be constrained by the 18th amendment which limits the use of the gas tax to "highway" purposes (although there might be a constitutional challenge to test this proposition). Local governments would benefit if city and county rates were also imposed on fuel.

- **Local matching incentives or maintenance of effort requirements**. This would reward local jurisdictions that tax themselves for transportation. This could be a direct allocation match from state funds and would encourage greater use of local funds and revenue authority. Such a proposal would provide incentives to local governments to use their existing unused revenue authority within existing legal constraints. An obverse idea would be to provide new local revenue authority with a requirement that no other previously used local sources could be supplanted. This would address the issue occasionally raised that when local governments have been given new revenue authority, they have sometimes used it to shift or supplant other previously used funds, leaving overall revenues for transportation unchanged.

  This proposal could be opposed by jurisdictions that are already using their maximum existing revenue authority because they would receive no benefit from it. Also, smaller jurisdictions might not benefit if they tend to have smaller tax bases and greater resistance to increasing taxes. The proposal to have the state provide matching funds could also be opposed by state officials who might fear the unpredictability of local match funds required.

- **Create a new "vehicle impact fee."** This proposes a flat fee to be imposed on the sale of each new motor vehicle in the state, with revenues directed to local governments. The benefits of such a fee would be that it would be a user fee tied directly to the impacts of a vehicle on the roadway system. Depending on the amount of the fee, it might be a good revenue generator, however it would likely be opposed by the auto industry. There would likely also be a distribution issue, since car dealers tend to be clustered in a single location, while selling to customers from many jurisdictions, including out of state, thus leading to the problem of how to distribute the revenues to local governments.